

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 24th Floor
San Francisco, California 94105**

**NOTICE OF PROPOSED ACTION AND
NOTICE OF PUBLIC HEARING**

Removal of Restrictions on Mortality Adjustment Factors

Date: September 20, 2010

Regulation File: REG-2010-00007

SUBJECT OF PROPOSED RULEMAKING

The Insurance Commissioner proposes to amend California Code of Regulations (“CCR”) Title 10, Chapter 5, Subchapter 3, Article 12.3 (“Valuation of Life Insurance Policies”) Section 2542.4, titled “General Calculation Requirements for Basic Reserves and Premium Deficiency Reserves” as described below after considering comments from the public.

PUBLIC HEARING

The Commissioner will hold a public hearing to provide all interested persons an opportunity to present statements or arguments, either orally or in writing, with respect to the proposed amendments to Section 2542.4, as follows:

Date and time:	Tuesday, November 16, 2010 at 10:00 a.m.
Location:	Department of Insurance Administrative Hearing Bureau Library 45 Fremont Street, 22nd Floor San Francisco CA 94105

The hearing will continue on the date noted above until all testimony has been submitted or until 5:00 p.m., whichever is earlier.

PRESENTATION OF WRITTEN COMMENTS; CONTACT PERSONS

All persons are invited to submit written comments on the proposed amendments to Section 2542.4 during the public comment period. The public comment period will end at **5:00 p.m. on November 16, 2010**. Please direct all written comments to the following contact person:

Nancy Hom, Senior Staff Counsel
California Department of Insurance
45 Fremont Street, 24th Floor
San Francisco, CA 94105
Telephone: (415) 538-4144

Questions regarding procedure, comments, or the substance of the proposed action should be addressed to the above contact person. In the event the contact person is unavailable, inquiries regarding the proposed action may be directed to the following backup contact person:

Stesha Hodges, Staff Counsel
California Department of Insurance
45 Fremont Street, 24th Floor
San Francisco, CA 94105
Telephone: (415) 538-4428

DEADLINE FOR WRITTEN COMMENTS

All written materials must be received by the Insurance Commissioner, addressed to the contact person at her address listed above, **no later than 5:00 p.m. on November 16, 2010**. Any written materials received after that time may not be considered.

COMMENTS TRANSMITTED BY E-MAIL OR FACSIMILE

The Commissioner will accept written comments transmitted by e-mail provided they are sent to the following e-mail address: homn@insurance.ca.gov. The Commissioner will also accept written comments transmitted by facsimile provided they are directed to the attention of Nancy Hom and sent to the following facsimile number: (415) 904-5729. **Comments sent to other e-mail addresses or other facsimile numbers will not be accepted. Comments sent by e-mail or facsimile are subject to the deadline set forth above for written comments.**

ACCESS TO HEARING ROOMS

The facilities to be used for the public hearing are accessible to persons with mobility impairments. Persons with sight or hearing impairments are requested to notify the contact person(s) for the hearing in order to make special arrangements, if necessary.

AUTHORITY AND REFERENCE

The Insurance Commissioner proposes to adopt amendments to Title 10, Chapter 5, Subchapter 3, Article 12.3, Section 2542.4 pursuant to the rulemaking authority vested in him by Insurance Code Section 10489.94 of the Standard Valuation Law. The Commissioner's decision on the proposed amendments to Section 2542.4 will implement, interpret, and make specific the provisions of Insurance Code Section 10489.94.

INFORMATIVE DIGEST

SUMMARY OF EXISTING LAW AND POLICY STATEMENT OVERVIEW

Insurance Code Section 900 requires that every insurer doing business in California file an annual statement with the Department of Insurance each year. Insurance Code Section 10489.15 requires that certain financial information be included in the annual statements filed by life

insurers, including information on the sufficiency of the insurer's reserves to cover future obligations such as claims.

Existing CCR Section 2542.4, titled "General Calculation Requirements for Basic Reserves and Premium Deficiency Reserves," contains requirements that life insurers must comply with in calculating reserves for life insurance. Existing Section 2542.4 allows companies to adjust the deficiency reserves by using mortality adjustment factors (known as "X factors") which are based on company experience. The X factors are used in determining the deficiency reserve amount required by the regulation. Section 2542.4 contains two restrictions on the X factors: (1) X shall not be less than 20%, and (2) X shall not decrease in successive years. Section 2542.4 is based on and derived from National Association of Insurance Commissioners ("NAIC") Model No. 830, Section 5, also titled "General Calculation Requirements for Basic Reserves and Premium Deficiency Reserves."

In September 2009, when existing CCR Section 2542.4 was already in effect, the NAIC revised Section 5 of Model No. 830 by removing the X factor restrictions described above. The NAIC removed the restrictions so that insurers could adjust the valuation mortality used in the calculation of deficiency reserves to make the reserves correspond more closely with the expected mortality for a particular book of business. In other words, the revisions allow insurers to reserve more precisely and accurately and to lower their deficiency reserves when warranted.

The reduction in deficiency reserves due to the removal of restrictions on X factors could result in the reserves not being sufficient. To ensure that reserves are not inadequate, the revisions to Section 5 of NAIC Model No. 830 require an appointed actuary to make a statement each year as to the adequacy of reserves to pay benefits and expenses.

The Commissioner proposes to amend Section 2542.4 by adopting the NAIC's revisions as amendments to Section 2542.4. There are three reasons for doing so.

First, the amendments are necessary to achieve the same purpose as the NAIC's revisions: to allow insurers to adjust the valuation mortality used in the calculation of deficiency reserves so that the reserves will correspond more closely with expected mortality, without under reserving. This will enable insurers to reduce their deficiency reserves when the reduction is justified by supporting data, so that they can reserve more precisely and accurately. To the extent this allows insurers to lower their reserves, it reduces their costs. To the extent this cost reduction is passed along to insurance consumers the cost to consumers is reduced as well.

Second, because the amendments track the revisions made to the NAIC Model, they promote uniformity of standards among different states. At present, over forty states have adopted some version of NAIC Model No. 830. Both insurers and consumers can benefit if reserving standards become more uniform across various states. Insurers can do business more efficiently and their administrative costs are reduced, a cost reduction that can be passed on to consumers. The proposed regulations serve this purpose by ensuring that California's regulatory requirements are as consistent with those of other states as is possible under California law.

Third, Insurance Code Section 10489.94 states that it is the intent of the Legislature that the Commissioner adopt regulations containing the provisions of NAIC Model No. 830. The proposed amendments implement, interpret and make specific the provisions of this statute by amending Section 2542.4 so that it conforms with NAIC Model No. 830 as revised.

In short, the policies underlying the proposed action are to allow life insurance reserves to be accurate without becoming inadequate, to save money for insurers and consumers, to promote uniformity of standards among various states, and to effectuate the intent of the California Legislature as set forth in Insurance Code Section 10489.94.

EFFECT OF PROPOSED ACTION

The proposed amendments to Section 2542.4 follow the revisions made by the NAIC to Section 5 of Model No. 830 by removing the X factor restrictions described above. The restrictions are being removed so that insurers can adjust the valuation mortality used in the calculation of deficiency reserves to make the reserves correspond more closely with the expected mortality for a particular book of business. In other words, the revisions allow insurers to reserve more precisely and accurately and to lower their deficiency reserves when warranted.

The reduction in deficiency reserves due to the removal of restrictions on X factors could result in the reserves not being sufficient. To ensure that reserves are not inadequate, the revisions to Section 2542.4 require an appointed actuary to make a statement each year as to the adequacy of reserves to pay benefits and expenses, just as the NAIC Model No. 830 does.

The letter and number designations of some subsections of Section 2542.4, and references to some subsection numbers, have been changed and amended to accommodate the changes made by adopting amendments from the NAIC Model.

The proposed amendments to Section 2542.4 will promote uniformity of standards with those of other states by ensuring that California's regulatory requirements are as consistent with those of other states as is possible under California law. It will also effectuate the provisions of Insurance Code Section 10489.94, which states that it is the intent of the Legislature that the Commissioner adopt regulations which contain the provisions of NAIC Model No. 830.

MANDATES ON LOCAL AGENCIES OR SCHOOL DISTRICTS

The proposed amendments to Section 2542.4 do not impose any mandate on local agencies or school districts. There are no costs to local agencies or school districts for which Part 7 (commencing with Section 17500) of Division 4 of the Government Code would require reimbursement.

COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES OR SCHOOL DISTRICTS OR IN FEDERAL FUNDING

The Commissioner has determined that the proposed amendments will result in no cost or savings to any state agency, no cost to any local agency or school district that is required to be

reimbursed under Part 7 (commencing with Section 17500) of Division 4 of the Government Code, no other nondiscretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State.

ECONOMIC IMPACT ON BUSINESS AND THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE

The Commissioner has made an initial determination that the amendment of this regulation may have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states. The types of businesses that may be affected are insurance companies. Although the Commissioner expects that the amendments will reduce costs overall because the amendments remove restrictions on the use of mortality adjustment factors, thereby allowing insurers to lower their reserves, insurers may incur some administrative costs as a result of modifying the way they calculate reserves.

The Commissioner has considered performance standards, but the Commissioner has identified no performance standards which would be as effective as the proposed amendments to Section 2542.4 in removing the mortality adjustment factor restrictions from Section 2542.4.

The Commissioner has not considered other proposed alternatives that would lessen any adverse economic impact on business and invites you to submit proposals. Submissions may include the following considerations:

- (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to businesses;
- (ii) Consolidation or simplification of compliance and reporting requirements for businesses;
- (iii) The use of performance standards rather than prescriptive standards;
- (iv) Exemption or partial exemption from the regulatory requirements for businesses.

POTENTIAL COST IMPACT ON PRIVATE PERSONS OR BUSINESSES

The Commissioner has determined that for insurance companies subject to the proposed amendments there is likely to be some cost impact, although it will most likely be minimal. The cost impact would be the cost of modifying the manner in which the insurer makes its deficiency reserve calculation. As noted above, the overall effect of the amendments is expected to be a reduction in an insurer's reserves, and therefore a reduction in its overall costs.

The Commissioner is not aware of any cost impacts that a representative private person or business, other than the insurers, would necessarily incur in reasonable compliance with the proposed action.

EFFECT ON JOBS AND BUSINESSES IN CALIFORNIA

The Commissioner is required to assess any impact that the amendments to Section 2542.4 may have on the creation or elimination of jobs in the State of California, the creation of new businesses, the elimination of existing businesses, and the expansion of businesses currently

operating in the state. The Commissioner does not foresee that the proposed amendments will have an impact on any of the above, but he invites you to comment on this issue.

FINDING OF NECESSITY

The Commissioner finds that it is necessary for the welfare of the people of the state that the regulation, as amended, apply to businesses.

IMPACT ON HOUSING COSTS

The proposed amendments to Section 2542.4 will have no significant effect on housing costs.

ALTERNATIVES

The Commissioner must determine that no reasonable alternative considered by the Commissioner or that has otherwise been identified and brought to the attention of the Commissioner would be more effective in carrying out the purpose for which this action is proposed or would be as effective and less burdensome to affected private persons than the proposed action.

IMPACT ON SMALL BUSINESS

The Commissioner has made an initial determination that the adoption of the proposed amendments to Section 2542.4 will not affect small businesses. Insurers are not small businesses under Government Code Section 11342.610(b)(2). However, the Department invites public comments on the question of economic impact on small businesses.

COMPARABLE FEDERAL LAW

There are no existing federal regulations or statutes comparable to Section 2542.4, as amended.

TEXT OF REGULATIONS AND STATEMENTS OF REASONS

The Department has prepared an Initial Statement of Reasons that sets forth the reasons for the proposed action. Upon request, the Initial Statement of Reasons will be made available for inspection and copying. Requests for the Initial Statement of Reasons or questions regarding this proceeding should be directed to the contact person listed above. Upon request, the Final Statement of Reasons will be made available for inspection and copying once it has been prepared. Requests for the Final Statement of Reasons should be directed to the contact person listed above.

The file for this proceeding, which includes a copy of the express terms of the proposed action, the Initial Statement of Reasons, the information upon which the proposed action is based, and any supplemental information, including any reports, documentation and other materials related to the proposed action that is contained in the rulemaking file, is available by appointment for

inspection and copying at 45 Fremont Street, 24th Floor, San Francisco, California 94105, between the hours of 9:00 a.m. and 4:30 p.m., Monday through Friday.

AUTOMATIC MAILING

A copy of the proposed amendments to Section 2542.4 and this Notice, including the Informative Digest, which contains the general substance of the proposed amendments to the regulation, will automatically be sent to all persons on the Insurance Commissioner's mailing list.

WEBSITE POSTINGS

Documents concerning this proceeding are available on the Department's website. To access them, go to <http://www.insurance.ca.gov>. Find at the righthand side of the page the heading 'QUICK LINKS.' The third item in this column under this heading is 'For Insurers'; on the drop-down menu for this item, select 'Legal Information.' When the 'INSURERS: LEGAL INFORMATION' screen appears, click the third item in the list of bulleted items near the top of the page: 'Proposed Regulations.' The 'INSURERS: PROPOSED REGULATIONS' screen will be displayed. Select the only available link: 'Search for Proposed Regulations.' Then, when the 'PROPOSED REGULATIONS' screen appears, you may choose to find the documents either by conducting a search or by browsing for them by name.

To browse, click on the 'Currently Proposed Regulations' link. A list of the names of regulations for which documents are posted will appear. Find in the list the "Removal of Restrictions on Mortality Adjustment Factors" link, and click it. Links to the documents associated with the proposed amended regulation will then be displayed.

To search, enter "REG-2010-00007" (the Department's regulation file number for the amended regulation) in the search field. Alternatively, search by keyword ("mortality adjustment factors" for example). Then, click on the 'Submit' button to display links to the rulemaking documents online.

MODIFIED LANGUAGE

If the amended regulation adopted by the Department differs from that which was originally made available but is sufficiently related to the action proposed, it will be available to the public for at least 15 days prior to the date of adoption. Interested persons should request a copy of the amended regulation prior to adoption from the contact person listed above.